

Kentucky Retirement Systems

Kentucky Employees Retirement System – County Employees Retirement System – State Police Retirement System

ANNUAL PROGRESS REPORT FOR CALENDAR YEAR 2008

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Presented to the KRS Board of Trustees
April 2, 2009

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Executive Director's Letter



ANNUAL PROGRESS REPORT EXECUTIVE DIRECTOR'S LETTER Robert M. Burnside, Executive Director

April 2, 2009

Dear Board Members:

On behalf of the Executive Management and staff of Kentucky Retirement Systems, I am pleased to present the Board of Trustees with the *Kentucky Retirement Systems Annual Progress Report for Calendar Year 2008*.

Several noteworthy events occurred this past year that will likely have significant long-term influence on KRS operations. First, the governor called the Kentucky General Assembly into special session in late June 2008 with the specific purpose of passing “pension reform legislation.” House Bill 1 was the culmination of several months of discussions between the governor’s administration and House and Senate leaders, and it made sweeping changes to the benefits offered members who join the Systems on or after September 1, 2008. Additionally, the Governor formed a Public Pension Working Group by Executive Order to study retirement issues in depth and provide options for consideration for future changes to the state’s retirement systems.

Another event that kept our staff extremely busy this year was the closing of the early retirement incentive windows at the end of December. KRS counselors calculated over 8,500 final retirements in calendar year 2008, including the retirement papers for many of our own staff. As a result, KRS lost many of its most experienced employees and a number of changes in key staff have occurred at all supervisory levels.

KRS staff and our partner, Bearing Point, continue to work at an ever-increasing pace to implement the START program. As we have entered into the final stages of a major implementation for June 2009, the demands on our staff have increased and it has been a total team effort to ensure our daily operations are not impacted.

Executive Director's Letter, Continued

Finally, the Systems' investment division has been busy managing the effects of the current global recession on our trust funds. While we are obviously concerned about the downturn in the economy and the corresponding reduction in trust fund assets, our challenge is to structure the portfolio to allow us to maximize our position when the market begins to recover.

The following pages outline the year's major events in more detail, and provide insight into the daily operations of many KRS divisions. Our Chief Officers and Division Directors will be available at the Board meeting to address any questions you might have.

Sincerely,

Robert M. Burnside
Executive Director

Benefit Services



DISABILITY DIVISION **Charlene Haydon*, Director**

In 2008 the Disability Division consisted of the Applications Branch and the Review Branch. Our Division processes disability applications and performs annual medical and employment reviews for disability recipients. The Division currently has 16 employees.

Counselors in this Division assist active and retired members with retirement paperwork and questions regarding disability and early retirement. This involves processing incoming retirement applications and preparing estimates, finals and purchases. Our counselors assist our membership by phone and in the office. Once all necessary documents are filed by the member the counselors prepare the case for the Medical Examiners and notify the members of the decision. We prepare final audits and check for overpayments due to Social Security and Workers' Compensation payments. Our counselors prepare hearing affidavits on pending disability hearing cases. We also conduct annual reviews on all disability recipients.

The support staff employed in the Review Branch are responsible for copying and tracking cases that are given to the Medical Examiners. They transcribe dictation on every case reviewed by the Examiners. At the end of each quarter this staff prepares invoices and submits information to our accounting Division for payment. These employees also process and distribute daily mail to the counselors in the Division.

*Effective January 1, 2009, Liza Welch took over as director of this Division. It was decided not to fill the Applications Branch Manager position vacated by Liza, and Brooke Pulliam was assigned with managing both the Review and Applications Branches. The Disabilities Support Branch was created and consists of the support staff originally employed under the Review Branch. A position of Document Support Supervisor was created to manage the Disabilities Support Branch, and Missy Gaines was hired for the position.

Summary of 2008 Activities:

- Processed 893 disability applications.
- Calculated 658 final retirements, 2527 retirement estimates, 370 service purchases, conducted 550 final audits and approximately 270 audits for hearings and DAC cases.
- 25% of applications were approved for Disability Retirement.
- 75% of applications were denied for Disability Retirement.
- Handled approximately 31,689 telephone calls.
- Counseled 834 visitors in office.
- Contacted 713 disability retirees for Annual Review.
- Continued 87% during Annual Review.
- Terminated 1% during Annual Review.
- 12% of Annual Reviews from 2008 are still pending a final decision.
- Continued testing finals and estimate program (BEN026).
- Performed audits on Medical Examiners' dictation and transcription.
- Assisted Retiree Services and Membership Support with verifying initial payroll for January 2009 retirements.
- Assisted Employment Services with estimate calculations backlog due to January 2009 retirements.
- Participated in START Vendor Acceptance Testing for Phase 5 designs related to annual reviews.

Current Status:

- Continue to provide education/training sessions for our staff as needed.
- Conducting disability education sessions for new hires.
- The Application Branch is responsible for processing all disability applications. Currently we process an average of 74 applications each month.
- Processing all disability finals within an average of 6 days of receipt.
- Performing audits on Medical Examiners' dictation and transcription.
- Conducting final audits within 3 months of initial retirement date, the earliest point at which the audit can be conducted.
- Conducting SSA/WC audits within 3 months of initial retirement benefit.
- Contacting disability recipients regarding Annual Reviews. Starting with January 2009, we are conducting annual reviews on a monthly basis.
- Test estimates and finals program on disability pay codes.
- Perform testing on disability annual statements.
- Four employees will be participating full-time with Phase 4 and 5 User Acceptance Training for START for a minimum of 6 weeks.
- Participating in START design sessions for Phase 6.
- Interviewing for a new Medical Transcriptionist.
- Currently looking to hire two Medical Examiners.

Strategic Plan for 2009 - 2010:

- Conduct internal audits to ensure accuracy.
- Conduct audits on Medical Examiners' dictation and transcription.
- Process disability finals within an average 10 days of receipt.
- Provide training sessions to disability staff on procedures to ensure statute/regulation compliance.
- Test disability annual statements.
- Test estimates and finals program (BEN026 and START).
- Monitor the disability process from receipt of initial application until a final decision has been made by the Medical Review Board and look for process improvements.
- Process Annual Disability Reviews monthly.
- Monitor disability information on web site.
- Assist other Divisions when needed.
- Support the START project.
- Review/implement START recommendations as they impact the Division.
- Participate and provide assistance to START design, testing and implementation.

Benefit Services



EMPLOYER SERVICES DIVISION

Sarah Webb, Director

The Division of Employer Services currently consists of 11 employees, including one Director and 10 Field Service Representatives.

The Division's responsibilities include, but are not limited to, the following: explains retirement system programs to non-participating agencies and their employees. Provide benefit calculations and pre-retirement counseling to members at designated sites across the state. Instructs participating agencies in the proper procedures to inform employees of retirement systems information, to maintain correct records, files and reporting procedures. Conduct Pre-Retirement Conferences across the state to educate employees and Reporting Official Conferences to educate employers.

Summary of 2008 Activities:

- Assisted **5** agencies in joining KRS and assisted **63** agencies in converting various positions to hazardous.
- Staff traveled **143,358** miles to visit **2,896** agencies, and conducted **7** One-on-One Conferences and **2,545** counseling sessions.
- Staff prepared/checked **9,934** estimates and **1,733** purchases.
- Conducted **38** workshops across the state to educate on HB1.
- Staff assisted with keying 3,000+ participation dates to members files to assist with the implementation of HB1.
- Staff assisted with visitor rotation to help out with the 1/09 window.
- Created new hazardous duty forms (for HB1) and had the packet placed on the website for employers to download.
- Created a knowledge base on issues and questions that came out of the implementation of HB1.

Current Status:

- 3 staff members of Division have been assigned to the START project on a full-time basis.
- In the process of obtaining information from the agencies that recertified hazardous duty positions. Once information is obtained we will be auditing and billing the difference between hazardous and non-hazardous contributions.
- Attending START meetings on a weekly basis.
- Assisting with getting agencies that are currently on KRS Pay 3 to upgrade to KRS Pay 4.
- Auditing several agencies that have been audited by the State Auditor.
- Drafting a letter to send out to all employers that did not recertify hazardous duty positions.
- Created a new agency listing identifying pre and post 9/1/08 hazardous duty positions.

Strategic Plan for 2009 - 2010:

- Provide continued education and training for staff.
- To complete hazardous audit of agencies that owe contributions due to retroactive date of 9/1/08 (HB1).
- Field staff will continue to make routine visits to agencies within their designated areas and perform regular employer-related duties.
- Assist other Divisions with workload that has been generated by HB1.
- Conduct meetings with agencies on new legislation and re-educating on HB1.
- Continued participation in the START project.

Benefit Services



EMPLOYMENT SERVICES DIVISION

Becky Stephens, Director
Shauna Miller, Interim Director

The Division of Employment Services contains 6 Branches and 40 employees including 1 Director, 6 Retirement Program Managers, 3 Retirement Benefits Analysts, 27 Benefits Counselors and 3 Administrative Assistants. The 6 Branches are: Benefits Audit, Counseling and Administration, Deceased Member Benefits, Pending Retirement, Purchases, and School Board Audit. The Division is responsible for training all benefits counselors of the following divisions: Employment Services, Membership Support, Disability, and Field Services. All counselors within the Division assist members who visit the office or contact the office via e-mail, phone, fax, or mail for retirement information including benefit and service purchase calculations.

The **Benefits Audit Branch** is responsible for conducting final retirement audits to ensure accurate benefits are paid to retirees; testing annual statement programs for accuracy and responding to annual statement inquiries and correspondence; and responding to requests for retirement information as a result of divorce proceedings.

The **Counseling and Administration Branch** is responsible for the reception area for non-retired members or beneficiaries for non-retired members; testing of all IT programs, including KRS' web calculators, used to calculate benefits and service purchases; responding to general correspondence received through the mail; and maintaining the Benefits Procedures Manual that is used by the divisions outlined above. Staff also provides assistance with the maintenance of all forms used by Benefits Services. Staff works closely with the IT Division to implement federal, state, and actuary changes to all pre-retirement benefits programs, while training all KRS users of these programs.

The **Pending Retirement Branch** is responsible for processing Notifications of Retirement forms received through the mail; checking all final retirement calculations received in the office; ensuring members' initial retirement benefits include all service purchases; coordinating reciprocal benefits with the Judicial Retirement Plan (JRP), the Legislators' Retirement Plan (LRP), and Kentucky Teachers' Retirement System (KTRS); and checking all retirement calculations for which a Qualified Domestic Relations Order has been filed. Effective March 1, 2009 this branch is also responsible for ensuring that all required retirement forms are received in office in a timely manner in order to process the member's first retirement benefit.

The **Purchases Branch** is responsible for checking all purchase calculations to ensure accuracy prior to the deduction of contributions for installment purchase plans; responding to member inquiries for cost calculations; auditing lump sum purchases; and reviewing omitted billings refuted by participating employers of the Systems.

The **Deceased Member Benefits Branch** is responsible for processing benefits for beneficiaries of deceased, inactive and active members and testing IT programs involving death calculations prior to retirement. Branch staff is also responsible for auditing accounts that require notification from KRS with regard to Federal Minimum Distribution requirements.

The **School Board Audit Branch** is responsible for adjusting service credit of school board members that do not average 80 hours of work per month and ensuring proper service credit is given

at the end of each school year. Branch staff also reviews accounts with reciprocity between KRS and JRP, LRP, and KTRS to ensure no overlapping of service credit occurs.

Summary of 2008 Activities:

Counseled **10,060** members in office, calculated **8,506** final retirements, conducted **4,790** retirement audits, processed **612** death reports, calculated **73,263** retirement estimates and service purchase calculations, audited **750** lump sum purchases, processed **46,878** pieces of mail, and handled **34,700** telephone calls.

- Began 2008 with a response time of four weeks for estimate and purchase inquiries received via phone and correspondence and ended the year with a response time of eight weeks.
- Maintained appointment availability at an average of two weeks. At one point during the year, 15 counselors were dedicated to assisting members who visited the office and the waiting period for an appointment was 6 weeks.
- Worked with BearingPoint and KRS staff to design and test workflow processes for Phase 4 of START. Participated in numerous design sessions relative to processing benefits for deceased members and retirees for Phase 5 of START.
- Assisted Division of Retiree Services with mandated insurance open enrollment for 2009 plan year.
- Management of Division participated in KRS' Organization/Human Resources Assessment by preparing documentation and participating in interviews with Carlson-Dettman Consultants.
- Staff attended training for Microsoft Office 2007 applications.
- Retired by mail or office visit KRS' largest number of retirees for a given month due to expiration of retirement incentive windows.

Current Status:

- Becky Stephens, Director of Employment Services, became the START Business Lead effective 11/1/2008. Six (6) additional employees of the Division have been dedicated to the START Project. User Acceptance Testing for Phases 4 and 5 of START has required an additional 11 employees of the Division to be devoted to the START Project 100% of the workday.
- Final retirement calculations are processed within the timeframe required by statute.
- Response time to members' inquiries for benefit estimates and cost calculations is approximately one week. KRS receives an average of 150 inquiries per week for estimates and cost calculations.
- Office appointments are available within two days. Six (6) counselors are dedicated on a daily basis to assist members visiting the office.

- A backlog exists with final retirement audits due to record number of retirements for January 2009 caused by expiration of retirement incentive windows. In addition, the Division retired one retirement benefit analyst who was responsible for assisting with final audits. Counselors within the Division have been designated to assist to reduce the backlog in this area.
- High productivity levels and multi-tasking abilities are displayed by committed and experienced counseling staff with a focus on maintaining accurate records.
- Lori Wells, a Retirement Systems Counselor IV within the Division is currently completing the training of Katy Mershon, a retirement systems counselor within Membership Support, which was postponed last year due to the increased workload associated with the retirement window. Lori will also be providing Kelly Newton, another Retirement Systems Counselor IV within Membership Support, with updated counseling information to assist her with her newly revised job duties.
- Continue to assist BearingPoint and KRS teams to successfully implement Phases 4 and 5 of START. Staff will be testing the FileNet workflow and BPAS payroll functionality.
- Several division employees are currently attending a multitude of Phase 6 design sessions.
- Counselors and managers within the Division are assisting Retiree Services in processing a backlog of adjustments that are a result of final audits.

Strategic Plan for Future:

- Monitor office appointment availability and workload levels weekly to determine need to redistribute staff to assist other areas within Benefits Services or the START Project.
- Continue to assist the Bearing Point and KRS teams to successfully complete implementation of Phases 4 and 5 of the START Project.
- Continue to assist the BearingPoint and KRS teams to successfully design Phase 6, Employer Reporting and Calculations, of the START Project.

Benefit Services



MEMBERSHIP SUPPORT DIVISION

Suzanne Howe, Director

The Division of Membership Support is comprised of three branches with a total team of 40 members. We have 1 Director, 2 Managers, 1 Supervisor, 26 Counselors, 1 Administrative Assistant, 4 Office Service Assistants, and 5 Document Processing Specialists.

The call center component of this Division provides members with convenient access to knowledgeable staff without requiring them to make a trip to the office. With the use of their Personal Identification Numbers, members are able to obtain account specific information from a counselor by simply placing a call. When someone calls, the person makes a selection from the menu, which puts the call in a queue that includes all staff with the skill to answer that particular call. Although, the two branches of counselors are trained with specific areas of expertise, we continue to cross-train between the branches, so that we can utilize our team to assist the maximum number of callers. If the callers enter their account numbers, the phone system automatically pops the screen on the counselor's computer, allowing the counselor to access the member's account information from the very beginning of the call. The four Office Service Assistants are the operators of the call center and also provide support with our mail. Our one administrative assistant provides support to the counselors to minimize time off the phone, as well as importing all KRS faxes that arrive through the computer system. The five Document Processing Specialists are responsible for keying all insurance applications, both payrolls each month, all incoming membership information, and corresponding with our members regarding incorrectly completed forms.

Summary of 2008 Activities:

During 2008, our Division was challenged to meet the demand of our responsibilities while having fewer people performing the work. We had five counselors participate in training provided by Employment Services for new counselors followed by pairing with an experienced mentoring counselor to help them acquire the confidence and customer service skills we expect from our staff when they transitioned into the call center. We were further impacted by two team members on maternity leave and various team members participating full-time in START activities intermittently throughout the year.

Despite hurdles in staffing, Membership Support handled 271,968 calls in 2008, which was a 13.67% increase from 2007. Our counselors made 2,055 calls to DEI and insurance companies to assist them with their health coverage, a 22% increase from the previous year. The average counselor call from "Hello" to completing the folder comments at the end of the call took 7 minutes and 15 seconds. We responded to 2,561 KRS emails, a

38% increase from 2007. Due to the large number of retirements, the documents that were reviewed through the pre-audit process, largely by two team members, increased by 49% to 67,445. Due to the level of commitment we place on getting retirees processed in the month for which they apply, the counselors contacted members daily by email, fax, and letters to notify them of any missing information, which would keep them from being processed, resulting in 96.65% of our initial retirees receiving their first check on time. We issued 13,888 Personal Identification Numbers and make it a practice to ask for the PIN with each call so that our members are becoming accustomed to using them, which will be helpful in the new system as it is a requirement in order to use the self-service component. This division was responsible for importing 52,420 faxes which were distributed to all divisions of KRS. The increase in retirements and the full open enrollment for health insurance caused a significant increase in the data entry work for the year. The number of insurance applications to be keyed for 2008 quadrupled from the previous year to total 27,915 and payroll transactions keyed increased from 72,000 to 127,000. In addition to performing our normal job duties, I am pleased to report that my team was also able to assist Employment Services with preparing calculations from requests in the queues and assist Retiree Services with data cleansing in preparation for change to START.

Current Status:

Throughout 2008, we had staff in and out for countless meetings and weeks of Vendor Acceptance Testing. Now, like all the other Divisions of KRS, we are participating in User Acceptance Testing with End User Training looming on the horizon. Fortunately, following the end of the window, phone calls diminished somewhat so we have been able to catch up on our own data entry backlog, as well as again prepare calculations from the queues and work on data cleansing with Retiree Services. Continuing education classes have been temporarily suspended as we collaborate with other Divisions to deliver excellent customer service to our members while participating in the development, installation, and education necessary for the implementation of START.

Strategic Plan for 2009:

- Continue to analyze phone services in order to determine whether changes are needed in staffing or skill assignments in order to provide quality customer service as quickly as possible.
- Monitor recorded calls for quality assurance.
- Continue coaching for continued learning and customer service skills.
- Participate in all phases as appropriate in the design, testing, implementation, and education necessary for START.
- Work with other Divisions to minimize the amount of overtime that may be needed to complete all required tasks relating to KRS business and START.

Benefit Services



RETIREE SERVICES DIVISION

Lela Hatter, Director

The Division of Retiree Services comprised of 4 Branches and 36 employees, consists of 1 Director, 4 Retirement Program Managers, 27 Retirement Counselors, 1 Retirement Benefit Analyst, and 3 Administrative Assistants.

The **Initial Payroll Branch** is responsible for establishing the retirement account and to begin the monthly benefits, federal tax withholding, and direct deposit for member's or beneficiary's that are initially retiring or to pay out onetime Actuarial Refunds; establishing accounts and beginning initial payment to alternate payee's of Qualified Domestic Relations Orders upon a member's retirement; establish benefits for member's that are to be paid from the Qualified Excess Benefit Arrangement.

The **Recurring Payroll Branch** is responsible for adjustment calculations and account changes resulting from the final audit, disability approvals, cessation and reductions in benefit; billing and collection of payment from employers for sick leave used in final retirement calculations; maintaining of dependent children payments; retired re-employed cases; benefit changes or cessation resulting from payment option selection at retirement; maintaining federal tax withholding and direct deposit changes; collection of overpayments on the recipient's account.

The **Death Branch** is responsible for processing benefits for the beneficiary of a deceased retired member's account and continuing benefits to or paying account balances on remaining benefits for the beneficiary or ceasing benefits with no continuation to the beneficiary.

The **Insurance Branch** is responsible for processing health insurance applications for initial enrollments, qualifying event changes, Medicare eligibility and cancellation of coverage; maintaining of under age 65 KEHP and KRS Medicare eligible health insurance plans; premium reconciliation and refunds. Auditing and processing of file responses from Centers of Medicare and Medicaid Services (CMS).

All counselors assist retired members and beneficiaries who visit the office with questions or changes to their account. Administrative Assistants are responsible for the reception area for retired members and beneficiaries; responsible for preparing and distributing division mail, incoming faxes; certified mailings, payroll and mass mailings; address updates to recipient accounts and returned mail from the US Postal System.

Summary of 2008 Activities:

- Maintained 88,691 retirement accounts as of December 31, 2008.
- Maintained 61,992 insurance plans as of December 31, 2008.
- Processed 7,787 initial retirements in 2008; 1,792 initial retirements were processed for June 2008, which surpassed the 2007 record of 1,569 for the largest June retirement in history; 1,546 initial retirements were processed for August 2008.
- Processed 2,005 reported death cases.
- Counseled 7,982 retirees and beneficiaries in office for 2008; a total of 5,206 retirees and beneficiaries were counseled in office during the health insurance open enrollment period for the months of October, November and December.
- Terminated 214 plan holders under KEHP coverage for Plan Year 2009 for non-compliance to mandatory re-enrollment requirements.
- Reconciled 2007 RDS (Medicare Retiree Drug Subsidy Program) files.
- Processed 96,283 pieces of mail.
- Continued education sessions to all division staff.
- Updated the Retiree Procedures Manual as needed.
- Audited and corrected 32,205 accounts as part of the Data Cleansing Project for START.
- Reviewed and composed correspondence for the START Project.
- Implemented requirements of HB 1 pertaining to Reemployment of a Retired Member.
- Six staff members were assigned fulltime to the START Project.

Current Status:

- Processed 2,242 initial retirement accounts for the close of the retirement window; making January 2009 payroll, a record month.
- Continue response time of 6 business days in mailing death packet to beneficiary upon the notification of death.
- Complete the correspondence review and rewrite in conjunction with the START Project.
- Auditing and correcting of accounts as part of the Data Cleansing Project to ensure accuracy of information in preparation for conversion and Retired Implementation Phase of START.
- Ten staff members have been assigned fulltime to the START Project.
- Transferred the Insurance Branch (1 Retirement Program Manager and 9 Retirement Counselors) to the Retiree Health Care Division.
- Preparing for training and implementation of the START Phase IV and V.

Strategic Plan for future:

- Continue participation and assistance on START Project.
- Continue auditing and correcting of accounts as part of the Data Cleansing Project post implementation of the START system.
- Evaluate additional training needs following implementation of Phases IV and V of the START system.
- Monitor and reestablish new response times following implementation of START based on the functionality of new system.
- Monitor workload levels and redistribute staff as needed.
- Continue providing education training to staff.

Investments



ALTERNATIVE ASSETS DIVISION

Brent Aldridge, Director

The Division manages 60 private equity portfolios with 30 general partnership relationships. The Division is responsible for performing due diligence on alternative investments and partnerships and serving on Limited Partnership Advisory Boards. The Division is also responsible for monitoring daily transactions, reviewing legal documents and contracts for compliance with state law and the investment policy, and maintaining performance data. The Division continually monitors state and federal laws, regulations and issues related to investment of public funds.

Summary of 2008 Activities:

- Invested \$435 million in 7 private equity firms
- Processed 183 capital calls totaling \$415,612,586
- Processed 49 distributions totaling \$60,562,290
- Attended 6 annual meetings and 2 advisory boards meetings
- Reviewed and meet with 36 potential private equity investments throughout year
- Traveled 21 days during year performing job-related functions
- Retained ORG as real estate consultant
- Invested \$120 million in 3 real estate firms

Current Status:

- Monitoring partnerships cash flow data, valuations and portfolio company holdings
- Continuing to be proactive in identifying top-performing general partnerships for private equity and real estate investing
- Continue researching ways to address division's resource needs
- Continuing education mandate for staff

Activities Planned for 2009:

- Explore opportunities provided by the international private equity markets
- Research the merits of a co-investment program
- Research merits of clean-tech, infrastructure and timberland investments
- Continue to expand the real estate portfolio and take advantage of current market opportunities

Investments



COMPLIANCE

Joe Gilbert, Compliance Officer

The role of compliance as it relates to the KRS Fund is to serve as a line of defense in protecting and preserving the investment assets of the retirement systems. The Compliance Officer has the responsibility of ensuring that guidelines and procedures as outlined by KRS Investment Policies are being followed; and to report these findings to the Investment Committee and Chief Investment Officer. Further, the Compliance Officer assists in the development of policies and procedures, and aids in the necessary due diligence required to make sound investment decisions. The Division is responsible for monitoring daily purchase/sale transactions, investment manager's compliance with investment policy, reviewing investment legal documents and contracts for compliance with state law and investment policy, and maintaining performance data. The Division also monitors state and federal laws, regulations and issues related to investment of public funds.

Summary of 2008 Activities:

- Transitioned Securities Litigation responsibilities from the Equity Division to Compliance.
- Created a reconciliation process between two vendors for monitoring and filing security litigation claims.
- Completed monthly transaction reviews designed to test the quality and soundness of the custodian bank's accuracy, functionality, and reporting through comparisons with account managers.
- Completed monthly share reconciliations for the equity accounts ensuring that holdings as reported by the custodian bank and those reported by the account managers are in agreement.
- Reviewed bond purchases on a monthly basis to ensure that bonds were of investment grade at time of purchase
- Continued daily background monitoring through use of "Compliance Analyst" offered by Northern Trust, searching across accounts for holdings that fall outside of KRS Investment Policy guidelines.
- Completed monthly investment updates, which serve to both monitor performance and as a reporting tool.

- Completed quarterly checklists for both the Investment Committee and the Board, which serve to report on the compliance of guidelines, set forth by the Investment Policy.
 - Participated and assisted in the due diligence and search for a broad market international equity mandate.
 - Participated and assisted in the U.S. and Non-U.S. Equity, and Fixed Income annual manager reviews.
 - Transitioned approximately \$1.2 billion from Lehman Brothers Asset Management to NISA Investment Advisors to continue a U.S. Core Fixed Income mandate.
 - Provided Investment related information for the Comprehensive Annual Financial Report.
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Current Status:

- Continue current transaction review and holdings reconcilements processes, and monitoring and reporting activities, as the current procedures serve as a good foundation.
 - Continue involvement in due diligence manager and product searches and reviews.
 - Continue to monitor security litigation claims and continue to improve on those procedures.
 - A watch list for monitoring managers perceived to be a greater risk to the portfolio (weak performance, organizational concerns, compliance/regulatory issues, etc.) is being developed.
-

Strategic Plan for 2009 - 2010:

- Develop periodic manual testing to provide another layer of comfort in safeguarding the systems' assets, as too much reliance of "Compliance Analyst" could lead to potential risk of investment assets.
- Enhance the reporting of the Insurance Fund's performance to mirror that of the Pension Fund in response to its continued growth in market value, asset complexity, and increases in the number of managers.
- Although during the year more attention was given to the investment environment, will attempt to construct a more effective performance report by creating a section that is aimed towards overall market condition education, including driving factors.
- Complete and adopt procedures for the administration/monitoring of a "troubled" manager watch list.

Investments



EQUITY ASSETS DIVISION

Carlos B. Cracraft, Director

The Division manages two enhanced equity index portfolios and monitors five external equity portfolios. The Division is responsible for monitoring daily transactions and investment managers for compliance with the Investment Policy, reviewing legal documents and contracts for compliance with state law and the investment policy, and maintaining performance data. The Division also monitors state and federal laws, regulations and issues related to the investment of public funds.

Summary of 2008 Activities:

- Lisa Crabtree retired from the Equity Division in May 2008.
- Assisted Chief Investment Officer in development of KRS 5-Year Annual Investment Plan
- Continued implementation of Asset Liability Plan:
 - Completed search and funded dedicated Emerging Market allocation
 - Completed search for broad Market International Equity mandate.
 - Implemented International Small Cap and Frontier market allocation
- Continued involvement with Investment Committee and external managers.
- Transitioned Proxy Voting responsibilities to Equity Division from Compliance Division.
- Completed continuing education mandate for directors and staff.
- Transitioned Securities Litigation responsibilities from Equity Division to Compliance Division
- Internally managed S&P 1500 Indexed portfolios slightly outperformed benchmark in both Pension and Insurance Fund.
- Total Equity portfolio outperformed benchmark for calendar year in both the Pension and Insurance Funds.

Current Status:

- Implementation and funding of recent International equity additions (Small Cap and Broad Market)
 - Transitioning and replicating Pension Fund equity management structure to Insurance Fund.
 - Creating and updating new revised portfolio guidelines for each external manager.
 - Continuing education mandate for staff.
-

Strategic Plan for 2008 - 2009:

- Continue implementation of Asset Liability Modeling Study and Annual Five Year Plan recommendations.
- Researching and reviewing diversification and manager structure of Domestic Equity Allocation.
- Researching additional portfolio management and risk management software tools.
- Transition Securities Class Action monitoring and filing activities to Compliance Division.
- Research expansion of current continuing education requirements to include all investment positions.

Investments



FIXED INCOME ASSETS DIVISION

David Peden, Director

The Division of Fixed Assets consists of (2) Portfolio Managers, Laura Miller (TIPS) and Brian Carter (Cash) along with (1) back office support person, Michael Curtsinger. Staff monitors 5 external fixed income portfolios with a market value of \$3.00 billion, representing 25% of the pension and insurance fund assets. The Division manages approximately \$1.22 billion in cash equivalents and U.S. Treasury Inflation Protection Securities representing 10.3% of total assets. The Division is responsible for monitoring daily purchase/sale transactions, investment manager's compliance with investment policy, reviewing investment legal documents and contracts for compliance with state law and investment policy, and maintaining performance data. The Division also monitors state and federal laws, regulations and issues related to investment of public funds.

Summary of 2008 Activities:

- The Director of Fixed Income Assets Kenton Bottoms retired.
- Pension Fund – Core External Fixed Income portfolios 1- year return was -3.38 vs. benchmark 5.24.
- Pension Fund – TIPS portfolios 1- year return was -0.57 vs. benchmark -2.35.
- Pension Fund – Cash portfolio 1- year return was 2.83 vs. benchmark 1.80.
- Insurance Fund – TIPS portfolio 1- year return was -0.96 vs. benchmark -2.35.
- Insurance Fund – Cash portfolio 1- year return was 2.34 vs. benchmark 1.80.
- Aligned fixed income to new target (25%) set by the Asset/Liability Modeling Study.
- Staff did some preliminary due diligence on High Yield Bonds (conference call with HY managers). This search was slowed by both the retirement of Kenton Bottoms and the conditions of the credit markets.
- The Lehman Brothers Asset Management team went to Neuberger Berman.
- \$1.2 billion of assets managed by Lehman Brothers was moved to NISA Investment Advisory LLC.
- In September we made the decision to only accept U.S. Treasuries for collateral for overnight repo due to problems in the credit markets.
- All staff is current on Continuing Education Policy requirements.

Strategic Plan for 2009:

- Fund an active allocation to High Yield bonds, which could include U.S. high yield corporate bonds, U.S. bank loans, and Global high yield bonds.
- Perform annual due diligence assessment for each existing manager.
- Continue the process of evaluating Emerging Market debt managers for diversification to fixed income allocation.
- Work with investment team to conduct due diligence on commodity managers for the inflation hedge.
- Work with investment team to conduct due diligence on managers in the Absolute Return strategy.
- Explore the possibility of having an Asset Backed Securities specialists managed the remaining assets with Neuberger Berman (Lehman Brothers).
- Research options for the cash portfolio to find conservative alternatives to U.S. Treasuries for repo collateral like the new FDIC insured corporate bonds.
- Research adding a portfolio management system to enhance our ability to monitor/manage the portfolios and access the risk.

Operations



ACCOUNTING DIVISION Todd E. Coleman, CPA, Controller

The Accounting Division is responsible for the collection, posting and balancing of employer and employee contributions, including service purchase payments. The Division is responsible for transferring contributions to the custodial bank and for qualification of these funds. The Division is responsible for the transfer of funds from the custodial bank to the depository bank to provide for retiree payrolls, refunds and administrative expenses. In addition, the Division is responsible for adjustments to member accounts, issuing member and employer refunds and processing employer wage reports. The Division is also responsible for posting and reconciling all General Ledger transactions and providing system financial statements.

This is accomplished with 26 staff members made up of four branches. The **Cash Management Branch** is managed by Elizabeth H. Smith and she has seven additional staff members. The **Accounts Management Branch** is directed by Mary R. Satterly and she has six staff members on her team. The **Employer Reporting Branch** is overseen by Gina L. Franklin and she has five staff members. The **Accounting & Office Services Branch** is managed by Joe D. Morris and he has four staff members. The Accounting Audit Branch was dissolved as of December 31, 2008, and the Office Services Branch was consolidated with Accounting as of the same date. This reorganization was made due to the retirement of Donna B. Beckley, the former Director of Office Support. All audits are now overseen by the Division of Internal Audit, which reports directly to the Audit Committee of the Board of Trustees.

Summary of Calendar Year 2008 Activities:

- The Division maintained and balanced the account master (aggregate total of all individual member accounts) which is used to provide data for approximately 196,000 member annual statements.
- The Division maintained the General Ledger and produced fiscal year end, as well as interim, financial statements.
- Processed approximately 3,830 service purchases during the calendar year.
- Maintained an average of 2,750 installment contracts (1,710 before-tax and 1,040 after-tax) during 2008.
- Processed approximately 12,120 employer and member refunds.
- Division staff reinstated approximately 1,530 accounts from write-off.

- Completed in-house training sessions which consisted mainly of the implementation procedures for *Retired-Reemployed* and *Health Insurance Contributions* resulting from the passage of House Bill 1 in September 2008. External training was also obtained through GFOA, AGA, AICPA, KYCPA, IIA, and the Office for Employee and Organizational Development in the Personnel Cabinet of the Commonwealth.
- Processed approximately 29,000 wage reports; transferred the contributions to the custodial bank and completed daily qualifications of those funds.
- Participated in START requirement sessions which included gap-fit sessions and system design sessions.
- Continued to work with IT staff to implement pilot employer FTP reporting of contributions. We currently have 189 agencies successfully reporting through FTP.

Current Status:

- The Division processed approximately 135 installment purchases the first two months of calendar year 2009.
- The Division processed approximately 2,390 member and employer refunds during January and February, 2009.
- Processed approximately 5,000 employer wage reports in January and February, 2009.
- Division staff reinstated 150 accounts from write off the first two months of 2009.
- Continuing daily transfer and qualification of funds to maximize investment earnings.
- Participating in START design and testing sessions, including File Net, Workflow, Retiree Payroll, and Employer Reporting.

Strategic Plan for Fiscal 2010:

- Continue to perform all current responsibilities.
- Continue employee education and training.
- Evaluate staffing needs in order to allow for START plan design, training, and testing.
- Review and assess current procedures for process improvement.
- Expand pilot FTP reporting to include more employer reporting agencies, in anticipation of the START implementation.
- Continue participation in START design as we move into implementation of Phase 4 and Phase 5 modules and continue the design for Phase 6.

Operations



COMMUNICATIONS DIVISION

Scarlett Consalvi, Director

The Communications Division was established in November 2006 illustrating KRS' commitment to educating our membership by enhancing and streamlining our external communications to ensure that KRS clearly and concisely communicates with our membership and constituent audiences. The Division currently consists of one Director and two Communications Specialists.

To date, the Communications Division has been charged with carrying out the agency's communication goals and positioning KRS as a reliable source of information for all audiences. All external publications have been redesigned and now have a common look and feel. The Division works closely with other Divisions to determine publication needs, facilitate document reviews and gain legal and budgetary approval for publications. A publication calendar has been established to ensure all publications are reviewed in a timely manner and that all have a consistent message.

Summary of 2008 Activities:

- Created two Member/Employer newsletters to keep the membership informed regarding agency news, legislative issues, and other pertinent news. Worked closely with our external vendor to ensure that the agency received the maximum postal discounts for these mailings. (250,000 copies of each newsletter ordered and mailed)
- Created two newsletters to educate members and employers about the impact of House Bill 1 following the 2008 Special Legislative Session.
- Coordinate the printing and mailing of the 1099 forms with IT staff and external vendor. (97,602 copies printed and mailed)
- Coordinate the printing and mailing of the Annual Statements with IT staff and external vendor. (195,954 copies printed and mailed)
- Coordinate the printing and mailing of the CERS Election Package with KRS' Internal Auditor and external vendors. (171,757 copies printed and mailed)
- Revised, redesigned and coordinated the printing of the 'Informational Handbook for Retired Members.' (5,000 copies printed)
- Revised, redesigned and coordinated the printing of three "Special Tax Notice" publications. (9,500 printed for in-house distribution)

Communications Division, Continued

- Revised, redesigned, and coordinated the printing and mailing of 2008 Open Enrollment materials and follow up reminders for non-Medicare eligible retirees. (52,000 printed, distributed through initial mailing and in-house distribution throughout the year)
- Revised, redesigned, and coordinated the printing and mailing of 2008 Open Enrollment materials for Medicare eligible retirees. (56,000 printed, distributed through initial mailing and in-house distribution throughout the year)
- Coordinate the printing and mailing of the Annual Statements with IT staff and external vendor. (191,454 copies printed and mailed)
- Coordinate the printing and mailing of the “KRS Revised Wage Reporting” and “KRS Secure Email” publications.
- Revised, redesigned and coordinated the printing of “KRS Active Member Summary Plan Description” publications. (173,772 printed, distributed through initial mailing and in-house distribution throughout the year)
- Compiled, redesigned and coordinated the printing of “2008 Comprehensive Annual Financial Report” publications. (200 printed for in-house distribution)
- Worked to support the START Project reviewing, developing and maintaining correspondence for use in the new system.
- Updated agency forms as requested by other Divisions and Chief Officers.
- Worked with IT to develop and implement a KRS Intranet to facilitate internal communications.
- Monitor and update the content on the current KRS website. Began effort to fully redesign the website and utilize new communication methods.
- Ensure that all newsletters and other requested materials are provided to members in alternate formats (large print, PDF, Braille).

Activities Planned for 2008:

- Revise and publish all necessary publications. Full scope to be determined by the outcome of the priorities of the agency
- Expand the Division's focus to enhance internal KRS communication functions.
- In conjunction with IT, redesign, develop and implement the KRS website.
- Continue to review, rewrite and consolidate all agency correspondence in conjunction with START Project Phase 6.

NOTES